Remarks of Commissioner Linda K. Breathitt
Federal Energy Regulatory Commission

"2010 - A 30 TCF Journey"

INGAA 56th Annual Meeting

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I want to thank Jerry Halvorsen for inviting me to speak at INGAA's 56th Annual Meeting. San Antonio is such an attractive and historic city. I love the river walk and it would be nice if there was a river walk running along First Street, NE (with perhaps a few alligators in the river) for lunch time strolls.

We have already heard from some "forward-thinking" energy and policy experts this morning. As the title of my speech "2010 - a 30 Tcf Journey" conveys, I will focus on the future of the natural gas market and the critical role the interstate natural gas pipelines have in this market.

Several years ago, we heard a great deal about a 30 Tcf natural gas market by 2010. But, recent forecasts have been somewhat more conservative. The Energy Information Administration or EIA now forecasts natural gas demand at 27 TCF by 2010 while the National Petroleum Council expects demand to reach 29TCf by 2010. It is my view that to reach any of these forecasts, all stakeholders need to pay attention to every aspect

from the drill bit to the burner tip. Simply put, without foresight and coordination among the producer, pipeline and distribution communities, the projected levels of demand will just not be attainable.

Although this message may appear to be self-evident, the fact is that an equilibrium of supply and demand does not just happen. The latest Energy Outlook published by EIA concluded that "the past several years of relatively low prices have slowed exploration and drilling for new sources of supply, a trend that only recently began to reverse itself." Concerning natural gas demand, EIA noted "growing demand for gas has helped push prices to record levels. The eight-year economic expansion and the growing popularity of gas-fired generation facilities have put upward pressure on gas demand."

The fact is that the current low supply, high demand outlook has many implications for the future. Actions need to be taken now on the supply side to sustain the recent demand growth and to prepare for the forecasted increase in natural gas demand by 2010. The wellhead price of natural gas has been decontrolled since 1993. Because prices are the main factor influencing additional drilling, FERC's ability to influence supply is limited.

But, the Commission and interstate pipelines do play a pivotal role on the supply-side, notably through the certificate process. To attain the demand levels forecasted for 2010, existing supply sources need to grow and new supply sources need to be tapped. There was a recent story in Natural Gas Week in which a pipeline executive stated that the US would need 38,000 miles of new transmission pipeline over the next ten years. Whatever the increased need for infrastructure is, the Commission and the industry need to be ready for new construction that will be required to bring new supply to market.

It appears likely that several natural gas pipeline projects will be proposed for bringing Alaskan gas to the "lower 48" within the next year. At last count, there were five competing proposals. I believe it is logical to add Alaskan natural gas resources to the U.S. supply portfolio. Large and secure domestic supply sources such as Alaska need to be tapped.

I have had pre-filing meetings with several Alaskan pipeline sponsors. These meetings are especially useful in cases like these where the size and impact of the proposed projects is massive. Pre-filing meetings allow me as a Commissioner to receive information on upcoming projects directly. Because of the long lead times these types of projects require, doing some legwork up-front can provide benefits down the road. I know that there are

competing projects and I am not favoring any one proposal. Rather, my point is that all parties involved need to show the foresight to get Alaskan gas to the "lower 48" market. FERC recognizes the need to be engaged now to help ensure that a pipeline is built by the end of the decade.

Besides Alaska, growth in natural gas supply over the next ten years is projected to come from existing sources such as the Gulf of Mexico, the Rocky Mountains and Canadian sources. The challenge for FERC and the pipeline industry is to get the infrastructure in place to deliver natural gas to market. I also understand that the necessary infrastructure will not be built unless FERC continues to show a willingness to allow reasonable returns to pipelines. I have spoken on several occasions of the need for reasonable returns and will continue to do so.

FERC has recently issued a number of Final Rules which are intended to make the certificate process clearer and more efficient. While progress has been made, I feel that there are obstacles that still must be overcome. A majority of pipeline certificates are issued with little fanfare, but during the past several years the Commission has been faced with a number of controversial projects. One of the common elements of these proceedings was that the proposed routes created difficult challenges. These projects were either greenfield projects or were routed through heavily populated

areas. This evoked a strong reaction from landowners and local officials. Parties now are better informed and more active than in the past and their concerns must be addressed.

Another common element was that, due to the complexity and siting of these projects, there were myriad environmental concerns. Complex projects require time for the resource agencies and others to evaluate the impacts. In addition, there was the perceived strong demand for natural gas in certain regions of the country. Pipeline sponsors have a desire, and rightly so, to be able to meet expected demand on a timely basis. The end result of this combination of factors is that the pressure from all sides was intense and somewhat unhealthy. The pressure on all fronts was reminiscent of how the defenders of the Alamo must have felt. In all seriousness, when decisions are reached through such an adversarial process, generally none of the stakeholders involved are satisfied. It is my belief that a less painful and more effective process in such cases can be achieved through a willingness of all stakeholders to address and resolve disputes in a collaborative manner, early in the process.

I support the certificate outreach meetings, being conducted by the Office of Energy Projects, that started in Albany, New York last month. The objectives of these outreach meetings are to explore ways of resolving issues

by getting stakeholders involved as early in the process as is practical, to explore the best avenues for fostering settlements, and to reduce the Commission's application processing time.

Reports from the Albany meeting are promising. Pipeline representatives relayed some construction techniques that made siting less controversial. Resource agencies explained their concerns about being provided early warning for complex projects. Landowners stated that they believe that their interaction with land agents can be improved. They also explained that they wanted to be better informed as to the disruptions they should expect during the construction phase.

I understand that some routing decisions may not be made until close to the time of filing, but I believe that a key to a more effective process is to get all stakeholders informed as early as possible. Getting issues on the table early is essential. You cannot solve issues or disputes until you acknowledge that they exist. Hopefully, INGAA members will continue to be receptive to changes in the process that make sense. I also wanted to point out that I believe that the objectives of this outreach are attainable without the need for new rules or regulations.

I have discussed the importance of FERC's being proactive on the supply side, now I would like to turn to the other side of a potential 30 TCF

market - the demand side. The unbundling required under Order No. 636 caused a fundamental change in the natural gas marketplace and spurred the development of a variety of new services. I feel that it is important for the Commission to recognize that the changes occurring in the natural gas and electric industries are, in part, the result of our own actions.

I see several reasons for the recent spate of new service offerings by pipelines. First, as a result of unbundling, most pipelines were left with service offerings that were very similar to those of competing pipelines. In order to obtain a competitive edge pipelines needed to develop services that were responsive and flexible enough to differentiate them from competitors.

Second, pipelines customer profiles are rapidly changing. Gone are the days where 20-year fixed rate contracts with local distribution companies were the norm. Current contracts terms have trended down to one to three years. Marketers have become major customers on most pipeline systems, and most marketers desire flexibility in rates. But change brings with it new opportunities. Pipelines have responded to these opportunities by developing new services and showing a willingness to negotiate rates in order to meet the needs of its changing customer base.

A third factor bringing new opportunities for competition and innovation is gas-electricity convergence. Virtually all new generating capacity being added today will rely on natural gas, and FERC has seen the effect of this convergence on regulated pipeline services. To meet the needs of electric generation customers, numerous pipelines have proposed hourly firm transportation services intended primarily to serve electric generators.

Rick Richard, Chairman and CEO of Columbia Energy Group, was quoted last week in Gas Daily on the issue of change in the utility industry. Rick observed "[t]he industry is no longer changing every five years, it's happening every month." The end result is that pipelines need flexibility to thrive in today's ever-changing competitive landscape. In recognition of this changing natural gas market, FERC needs to provide pipelines some flexibility to met the needs of their new customers- the electric generators and marketers.

However, on a forward looking basis , INGAA's members also need to be cognizant of their existing customers' concerns when developing new services or service options. Change is hard; there seems to be a reticence and skepticism to embrace change. Consider the hourly services pipelines have implemented to serve electric generation loads. Existing customers

have raised valid concerns that the flexibility built into these new services may have an impact on the quality of their existing services.

Because the hourly services and other innovative services have no track record, it is difficult to predict with certainty the impact that new services will have on system operations. I believe that a sound approach would be to address the concerns that are raised when new services are first proposed. However, where concerns are raised that can not yet be addressed, the Commission may find it prudent to allow the service to be implemented, but to monitor the impacts of the service and get a report after the first year of operations. I believe that this approach appropriately balances the desire of the pipelines to offer services to meet the needs of their new customers with the concerns of existing customers.

I believe that in the near future we will see some of the services that are considered innovative today become commonplace. This occurred with some frequency during the deregulation of the telephone industry, where innovations such as call-waiting and caller-ID are now generally available. An example from the pipeline restructuring may be hourly services. Although the hourly services are relatively new, there has already been discussion of the need for this type of service on a more generic basis.

Conversely, some of today's innovative services may be considered ancient history by 2010.

I also believe that there will continue to be both small-scale and large-scale growth opportunities for natural gas pipelines in the next decade. Distributed generation holds potential for the residential market. Distributed generation offers residential customers the choice of using natural gas to produce electricity at their home. This can be accomplished through small gas turbines or through fuel cells. Although distributed generation is still in its nascent stages, I believe it holds much promise. On a larger scale, as most new electric generation is proposed to be fueled by natural gas, there will be opportunities for continued growth in this segment of the industry.

In closing, I would like to applaud the INGAA members for accepting the challenges that deregulation created. However, for continued growth to occur, we all need to pay attention to both sides of the market - supply and demand. Only then will it be possible for the market to continue to develop and grow to the heights forecasted by 2010.